Supreme Court, U.S.
FILED

96 525 OCT 1 1996

OFFICE OF THE CLERK

No.

IN THE

Supreme Court of the United States

October Term, 1996

JAMES MADISON LIMITED,
By Norman F. Hecht, Sr., Assignee,
PETITIONER,

v.

EUGENE A LUDWIG, COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY and FEDERAL DEPOSIT INSURANCE CORPORATION,
RESPONDENTS.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETITION FOR WRIT OF CERTIORARI

William Joseph H. Smith
Counsel of Record
Stohlman, Beuchert, Egan
& Smith, Chartered
1775 Pennsylvania Avenue, N.W.
Suite 400
Washington, D.C. 20006
(202) 452-1775

Counsel for Petitioner

October 1, 1996

CASILLAS PRESS, INC., 1717 K STREET, N.W., WASHINGTON, D.C. 20036

30 pp

QUESTIONS PRESENTED

1. When the Comptroller of the Currency ("Comptroller") declares a bank insolvent and appoints the Federal Deposit Insurance Corporation ("FDIC") as receiver to take possession of and liquidate the assets of a bank, without giving the bank prior notice and a hearing, does due process require that the bank be afforded the same due process rights that this Court has protected for other parties whose property has been taken by the government under extraordinary circumstances without prior notice and a hearing, i.e., the right to notice and the opportunity to present evidence and arguments contesting the legality of the taking prior to the time the government disposes of the property and thereby finalizes the deprivation of property?

2. Did the Court of Appeals err in ruling that the judicial proceedings initiated by the Banks, to contest the Comptroller's declaration of insolvency and the appointment of a receiver as being arbitrary and capricious action prohibited under the Administrative Procedure Act, provide the Banks with a due process hearing, when (i) the administrative record did not contain any evidence or arguments of the Banks because there was no meaningful opportunity for the Banks to participate in the making of the administrative record; (ii) all of the Banks' documents are in the possession and control of the government; and (iii) the District Court did not expand the administrative record to include all of the Banks' pertinent loan underwriting and credit documents?

3. When a bank contests the Comptroller's declaration of insolvency and the appointment of a receiver to take possession of and liquidate the bank's assets as arbitrary and capricious action prohibited under the Administrative Procedure Act, is the administrative record sufficient for the court

to perform its judicial function of making a "searching and careful" inquiry into the facts and to grant summary judgment for the Comptroller, when the pertinent documents in the administrative record are only summary reports, memoranda and charts, prepared by examiners based on their examination of the bank, setting forth their findings and reasoning for assessing additional loan loss reserves that made the Banks insolvent, or must the administrative record also contain the underlying evidence that the examiners allege support their findings and reasoning, i.e., the bank's pertinent loan underwriting and credit documents, so the court can determine whether all relevant factors were considered and whether there were any clear errors of judgment, as instructed by this Court in *Citizens To Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971)?

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES iv

OPINIONS BELOW 1

JURISDICTION 1

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED 1

STATEMENT 2

REASONS FOR GRANTING THE PETITION 9

A. Court Proceedings After Deprivation Of Property Has Been Finalized Does Not Satisfy Due Process Hearing Requirements. 11

B. Review Of Administrative Record That Does Not Contain Evidence And Arguments Of Bank Does Not Provide Due Process. 15

C. Administrative Record Not Sufficient For Court To Perform The Judicial Review Function Prescribed In *Overton Park* 18

CONCLUSION 24

TABLE OF AUTHORITIES

Cases Page

Calero-Toledo v. Pearson Yacht Leasing Co.,
416 U.S. 663 (1974).....11

Citizens To Preserve Overton Park v. Volpe,
401 U.S. 402 (1971).....ii, 10, 11, 18, 19

Coffin Bros. & Co. v. Bennett,
277 U.S. 29 (1928).....11

Fahey v. Mallonee, 332 U.S. 245 (1947).....11

FDIC v. Mallen, 486 U.S. 230 (1988).....11

Fuentes v. Shevin, 407 U.S. 67 (1972).....17

Mathews v. Eldridge, 424 U.S. 319 (1976).....12, 13

United States v. James Daniel Good Real Property,
510 U.S. _____, 114 S. Ct. 492 (1993)..... 7, 14

Universal Camera Corp. v. NLRB,
340 U.S. 474 (1951).....19

Woods v. Federal Home Loan Bank Board,
826 F.2d 1400 (5th Cir. 1987),
cert. denied, 485 U.S. 959 (1988).....16-17

Constitution, Statutes and Regulations

United States Constitution, Amendment V.....1, 14

Administrative Procedure Act
5 U.S.C. § 706.....2
5 U.S.C. § 706(2A).....6, 18, 19
5 U.S.C. § 706(2)(B).....7, 18

Page

Banking Act
12 U.S.C. § 26.....6
12 U.S.C. § 191.....6

Financial Institutions Reform, Recovery and
Enforcement Act 12 U.S.C. § 1464(d)(2)(B).....13

Home Owner Loan Act of 1933
12 U.S.C. § 1464(d)(6)(A), as amended 1979.....16

28 U.S.C. § 1254(1).....1

Rules and Regulations for the Federal Savings
and Loan System, § 206.2,
Hearing on Appointment.....13

PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case, No. 95-5126, entitled *James Madison Limited, by Norman F. Hecht, Sr., Assignee v. Eugene A. Ludwig, Comptroller of the Currency, et al.*

OPINIONS BELOW

The opinion of the Court of Appeals, entered May 3, 1996, is reported at 82 F.3d 1085 and it is reproduced in the Appendix at pp. 2a-25a. The Order amending the opinion of the Court of Appeals, entered July 3, 1996, is reproduced in the Appendix at pp. 26a-28a. The memorandum opinion of the District Court entered October 28, 1994 is reported at 868 F. Supp. 3 and is reproduced in the Appendix at pp. 32a-43a. The memorandum opinion of the District Court denying petitioner's motion for reconsideration, entered April 12, 1995, is reproduced in the Appendix at pp. 45a-50a.

JURISDICTION

The judgment of the Court of Appeals was entered May 3, 1996. App. 1a. The Order denying rehearing, and the Order denying the suggestion for a hearing en banc were entered July 3, 1996. App. 26a-29a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION AND STATUTES INVOLVED

The Fifth Amendment to the United States Constitution, and the relevant provisions of the Administrative Procedure

Act, 5 U.S.C. § 706, and the Banking Act, 12 U.S.C. § 191, are reproduced in the Appendix at pp. 51a-54a.

STATEMENT

This case arises from the Comptroller of the Currency ("Comptroller") declaring insolvent the Madison National Bank of D.C. and Madison National Bank Virginia (the "Banks"),[1] appointing the Federal Deposit Insurance Corporation ("FDIC") as receiver of the Banks, and permitting the FDIC to immediately dispose of the assets of the Banks. These actions were taken by the Comptroller based solely upon findings and reasons of bank examiners, set forth in their summary reports and memoranda, without any underlying supporting evidence being included in the administrative record and without at any time providing the Banks with the opportunity to be heard prior to the disposal of the Banks' assets. The Banks were not even given the opportunity to participate in a meaningful way in the making of the administrative record by submitting to the examiners the Banks' evidence and written arguments for consideration by the Comptroller and inclusion in the administrative record.

On the same day the Comptroller declared the Banks insolvent and appointed the FDIC as receiver, May 10, 1991, the Comptroller permitted the FDIC to enter into Purchase and Assumption Agreements with Signet Bank for the two Madison Banks, that imposed upon the FDIC and public a result equal to the worst case scenario for any bank, i.e., a run on the bank by depositors withdrawing all of the funds in their deposit accounts. The agreements provided for the immediate transfer

[1]The Banks were wholly-owned subsidiaries of James Madison Limited ("JML"), a national bank holding company, with its principal office in the District of Columbia.

to Signet Bank of all of the deposit accounts of the Madison Banks, all of the cash and liquid assets of the Banks totalling approximately $239,343,000.00, and a cash payment from the FDIC in the approximate amount of $557,399,000.00, which sums together equalled the amount of the deposit liabilities Signet assumed, less a discount of only $18 million.[2] Once the deposit accounts, cash and U.S. securities of the Banks were transferred to Signet, the deprivation of a significant portion of the Banks' assets became final and the business of the Banks was destroyed, causing the Banks to incur irreparable damage.

The administrative record, which served as the Comptroller's basis for the declaration of insolvency and the appointment of a receiver for the Banks, consists primarily of summary reports, memoranda, charts and loan loss reserve schedules prepared by the examiners and the staff employed by the Comptroller. The administrative record does not contain any evidence that the examiners allege support their findings of fact and reasons for assessing the additional $31.6 million loan loss reserves that made the Banks insolvent, i.e., copies of the pertinent loan underwriting and credit documents of the Banks. The District Court did not expand the scope of review to include such evidence, as requested by JML in its memorandum and supplemental memorandum in opposition to the Comptroller's motion for summary judgment.

On February 5, 1991, the OCC reduced the rating of the Madison Banks from a satisfactory rating to "5" under the Uniform Financial Institution's rating systems, which classified the Banks as having a strong probability of imminent failure.

---

[2]The FDIC paid such a large amount of cash to Signet Bank because the FDIC did not require Signet Bank to accept assignment of the Banks' loans, including the performing loans that comprised at least 75% of the loan portfolios, as assets supporting the deposit liabilities assumed by Signet. The FDIC retained all of the loans of the Banks for sale or collection by its staff.

The impending failure classification was based only on a two-day limited targeted review of the loan loss reserves for only 26 loans, at the end of January 1991, by two examiners from Texas, without providing the Banks with the opportunity to respond. The two examiners required $11,310,000.00 in reserves, a 281% increase over the $4,021,000.00 reserves established by the Banks for those same loans and 219% more than the $5,157,000.00 that was determined to be reasonable reserves for those loans by the Secura Group. The Secura Group was a bank consulting firm retained by the Banks, whose partner supervising the review of the Banks' loan loss reserves was a prior OCC bank examiner.

As a result of the limited targeted review and the "5" rating, the OCC commenced a detailed examination of the Banks' loan loss reserves on February 13, 1991 and completed the examination on or about May 1, 1991. During the examination, loan officers of the Banks received only 17 drafts of loan write-ups prepared by the examiners, which were the only notice the Banks received of the reasons for any of the additional loan loss reserves.[3] Toward the end of the examination, the examiners requested certain loan officers to meet with them, on short notice, to discuss 44 loans and to prepare short summaries of the Banks' position, for discussion purposes. The 44 loans discussed comprised less than half of the more than 100 loans for which the examiners assessed additional loan loss reserves of $100,000.00 or more. The Banks did submit to the examiner-in-charge a memorandum discussing why the migration formula prepared by the examiners should not be used, but the Banks never had the opportunity to present such arguments, with supporting evidence, to the Comptroller or a senior OCC official that was not directly engaged in the

[3]The Court of Appeals apparently overlooked a similar statement in JML's brief, p. 18, and the fact that JML had raised the notice issue below, when it stated that JML had not contested notice. App. 21a.

examination. Bank officers also met with senior OCC officials to complain about the high additional loan loss reserves being assessed by the examiners, the liquidation values being applied to real estate securing loans and the use of the migration formula. However, at no time during the examination were the Banks given the opportunity to present their evidence and arguments regarding the unreasonableness of the large additional loan loss reserves to any senior OCC official or hearing officer, or for inclusion in the administrative record for review by the Comptroller, examiners or any other OCC personnel.

On May 1, 1991, senior officials of the OCC and FDIC and the examiner-in-charge met with the directors of the Banks and advised them of the $31.6 million in additional loan loss reserves that the OCC was requiring the Banks to set aside in addition to the $24.4 million loan loss reserves the Banks had already established. The large amount of additional reserves made the Banks insolvent by a minus $6.5 million. The regulators also advised the directors that the Banks had nine days, until May 10, to submit a recapitalization plan that was satisfactory to the OCC. On May 8, the Banks submitted a recapitalization plan and on May 9 they transferred all of their assets to loan loss reserves as required by the OCC. On May 10, 1991, the Comptroller rejected the recapitalization plan, declared the Banks insolvent, appointed the FDIC as receiver, and permitted the FDIC to execute the Purchase and Assumption Agreements with Signet Bank.

Upon the appointment of the FDIC as receiver of the Banks, JML, the parent bank holding company, immediately lost substantially all of its assets and the purpose for its existence ceased. On May 10, 1991, the FDIC took possession and control of all the Banks' assets as well as all of the Banks' records and files, including all loan underwriting and credit files. Because the remaining assets of JML were insufficient to

satisfy its liabilities, JML filed a voluntary Chapter 11 bankruptcy petition on November 11, 1991.

This action is brought in the name of JML by Norman F. Hecht, Sr., a past President and Chairman of the Board of Madison National Bank of D.C., a past Director of Madison National Bank Virginia, and a Director, Vice President and stockholder of JML. On November 3, 1992, JML assigned to Mr. Hecht all of its rights and interest in all claims and causes of action it had against the federal government and any agency thereof relating to the seizure of the Banks and the right to bring such causes of action in the name of JML, all pursuant to the Amended Plan of Liquidation of JML, dated September 1, 1992, that was confirmed by Order of the Bankruptcy Court dated October 20, 1992.

The Complaint seeks a mandatory injunction against the Comptroller, OCC and FDIC under the provisions of the Administrative Procedure Act, 5 U.S.C. § 706(2)(A), ordering (i) the removal of the FDIC as receiver of the Madison Banks; (ii) the return of all of the assets of the Madison Banks still in the possession of the FDIC and all funds received by the FDIC from the sale of assets and collection of loans; and (iii) the return of the bank charters when the Banks again satisfy the requirements for the issuance of a charter pursuant to 12 U.S.C. § 26.

In Counts I and II of the Complaint, JML alleges that the examiners abused their discretion and acted arbitrarily and capriciously in requiring excessive additional loan loss reserves in the amount of $31.6 million that made the Banks appear insolvent when they were solvent. In Counts III and IV, it is alleged that the Comptroller acted arbitrarily and capriciously and failed to observe the procedure required by law in appointing the FDIC as receiver to liquidate the assets of the Banks, because he failed to make a "due examination" as required by the Banking Act, 12 U.S.C. § 191, as a result of the abuse

of discretion and arbitrary and capricious actions of the examiners.

On June 15, 1993, the Comptroller and OCC filed their motion to dismiss, or in the alternative, for summary judgment, and the administrative record. On January 28, 1994, JML filed its motion for leave to file an amended complaint primarily for the purpose of adding two due process counts under the Fifth Amendment and the Administrative Procedure Act, 5 U.S.C. § 706(2)(B), based on the fact that the Banks were not provided with the opportunity to participate in the making of the administrative record and the Comptroller did not provide the Banks with the opportunity for a hearing that satisfied the requirements of due process at any time prior to the time the deprivation of the Banks' assets became final. The impetus for moving for leave to add the two due process counts was the decision rendered by this Court in the prior month, December 1993, in *United States v. James Daniel Good Real Property*, 114 S. Ct. 492 (1993), which brought to JML's attention the line of cases in which this Court has ruled if circumstances warrant an immediate taking of property prior to giving the required notice and opportunity for a hearing, then due process is satisfied if notice and an opportunity for a hearing is provided prior to the time the deprivation becomes final.

Nine months after the motion for leave to amend the Complaint was filed, and more than a year after all memoranda were filed regarding the motions to dismiss or for summary judgment, the District Court, without oral argument, issued an Order on October 28, 1994, App. 30a-31a, (i) denying JML's motion for leave to add the two due process counts on the grounds that they were "without merit" and "futile," and (ii) granted summary judgment for the Comptroller, OCC and FDIC, on Counts I through IV of the Complaint, on the grounds that the statement of undisputed facts submitted by the Comptroller and OCC, that described only the examination procedure

followed by the examiners, which procedure and statement of facts was not contested by JML, and the administrative record filed by the Comptroller and OCC showed that there was a rational basis for the examination procedures followed and thereby a rational basis for additional reserves assessed. JML's motion for reconsideration was denied April 12, 1995. App. 44a.

The Court of Appeals issued its Opinion on May 3, 1996, affirming the denial of JML''s motion for leave to amend the Complaint to add the two due process counts on the grounds that (i) due process does not require a hearing prior to disposal of the Banks' assets by the government, App. 22a, and (ii) the judicial proceedings in the District Court and the Court of Appeals, involving a review of the administrative record, that consisted primarily of summary reports and memoranda of the examiners and OCC staff, and no supporting evidence, satisfied the hearing requirements of due process. App. 25a. The Court of Appeals also affirmed summary judgment for the Comptroller, OCC and FDIC based on its finding that the Comptroller did not act arbitrarily and capriciously and that the administrative record was adequate because the administrative record "contains detailed contemporaneous reports from the examiner-in-charge and members of her examination team explaining how and why they reached their conclusions regarding the Banks' reserves." App. 14a.

Neither the District Court nor the Court of Appeals tested any of the examiners' findings of fact, conclusions or reasons, set forth in the examiners' reports and memoranda, to determine if all relevant factors were considered by the examiners and if any clear errors of judgment occurred, because the evidence allegedly relied upon by the examiners was contained in the Banks' loan underwriting and credit documents, that were not included in the administrative record filed with the Court. JML, in its memorandum and supplemental memorandum in opposition to the motion to dismiss, requested the District

Court to expand the administrative record to include such pertinent loan underwriting and credit documents and, since they were in the possession of the FDIC,[4] to permit discovery of them if the affidavits submitted by JML regarding 12 loans did not contain sufficient evidence of examiners failing to consider relevant factors and making clear errors of judgment,[5] which the District Court did not do.

REASONS FOR GRANTING THE PETITION

The ruling of the Court of Appeals, that due process does not require a hearing prior to the disposal of a bank's assets by the government receiver, App. 22a, conflicts with the rulings of this Court that when circumstances warrant the immediate taking of possession of private property by the government, due proces is not denied, provided the owner is given notice and an opportunity to be heard before the deprivation of property becomes final. The Court of Appeals erred in ruling that the judicial proceedings, based on review of the administrative record, provided the Banks with a due process hearing, when no evidence or arguments of the Banks were included in the administrative record because the Banks had no meaningful opportunity to present their evidence and arguments to the Comptroller or examiners for their consideration and inclusion in the administrative record and because the court denied JML's request to expand the administrative record to include the pertinent bank loan underwriting and credit documents.

---

[4]Copies of the pertinent underwriting and credit documents were not made by the examiners for inclusion in the administrative record at the time the Comptroller declared the Banks insolvent. However, the FDIC took possession and control of all of the Banks' documents when it took control of the Banks as receiver on May 10, 1991 and they were available for inclusion in the administrative record filed in court.

[5]See pages 20-23 herein for a discussion of the loans comparing the examiners' findings to the facts in the Banks' documents described in the affidavits filed by JML.

If the ruling of the Court of Appeals stands, it will serve to perpetuate a bank liquidation procedure, imposed on banks by the Comptroller, that gives the Comptroller the power to close banks and immediately dispose of their assets, based solely on examination reports of his examiners, without any underlying evidence in the administrative record and without giving the banks an opportunity to be heard to protect themselves from unreasonable findings, mistakes of judgment by the examiners, or from overzealous or misguided actions or agendas of the Comptroller or his examiners. The decision of the Court of Appeals affirms a procedure that permits the Comptroller to declare banks insolvent and to appoint receivers to liquidate their assets, without being held accountable for the validity of his decisions, which can deprive banks of all their assets, usually worth hundreds of millions of dollars, without the protection of due process.

The ruling of the Court of Appeals, that the administrative record was sufficient for judicial review, pursuant to the provisions of the Administrative Procedure Act, because it contained detailed reports of the examiners that set forth their findings and explained their reasoning for the additional loan loss reserves they assessed that made the Banks insolvent, is contrary to, and ignores the instructions of this Court, that the judicial review function of the courts, regarding the review of administrative agency decisions, requires courts to make a "searching and careful" inquiry into the facts to determine whether all relevant factors were considered and whether any clear errors of judgment were made.[6] Because the administrative record did not contain any of the underlying evidence that the examiners allege support their findings and reasoning, i.e., the Banks' loan underwriting and credit documents for the pertinent loans, it was impossible for the

[6] *Citizens To Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971).

court to make the inquiry into the facts instructed by this Court in *Overton Park*, 402 U.S. 416. If the decision becomes precedent for other courts, it will make judicial review of the Comptroller's actions in closing banks a meaningless exercise that does not provide protection for banks from arbitrary and capricious closings and liquidation of their assets. This case merits the Court's exercise of its supervisory power to advise whether the searching and careful inquiry into the facts that it intended courts to make can be made if the underlying evidence, that is in the sole possession and control of the government, is not made part of the administrative record.

A. Court Proceedings After Deprivation Of Property Has Been Finalized Does Not Satisfy Due Process Hearing Requirements.

This Court has consistently held that due process is not denied when a valid governmental or public interest is at stake that justifies an immediate taking of private property, before notice and the opportunity to be heard is given to the owner, provided the owner is given notice and the opportunity to be heard by the agency, or in a judicial hearing, before the deprivation of property becomes final. *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663 (1974). See also three financial institution cases, *FDIC v. Mallen*, 486 U.S. 230 (1988), in which the FDIC suspended a bank officer from his employment without a hearing, but provided for a post-suspension hearing before the suspension became final; *Fahey v. Mallonee*, 332 U.S. 245 (1947), whereby the appointment of a conservator was being challenged before the assets of the savings and loan had been liquidated and the validity of the FHLBB hearing procedure after the taking was being challenged; and *Coffin Bros. & Co. v. Bennett*, 277 U.S. 29 (1928), where the stockholders had a full complement of judicial procedures available to them before the liens placed on their property by the state banking

commissioner, prior to a hearing, could be executed upon and a final deprivation of property occurs.

This Court has reasoned that under extraordinary circumstances, where there is a valid and important governmental or public interest at stake, that warrants a prompt taking of property, the government may take possession of the property without prior notice and a hearing because the notice and hearing may still be given at a meaningful time, i.e., before the deprivation of property becomes final. *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976).

In this case, the FDIC, on the same day it was appointed receiver, signed Purchase and Assumption Agreements for the two Madison Banks with Signet Bank, that provided for the immediate transfer of all deposit accounts and all cash and liquid assets of the Banks to Signet, totalling $239,343,000.00, plus $557,399,000.00 from the FDIC, that disposed of all of the liquid assets of the Banks and destroyed their business. Once all of the liquid assets and deposit accounts of the Banks were transferred to Signet, the government could no longer return the assets and credit accounts to the Banks if the Banks proved at a later date to a court that the appointment of the receiver should be revoked. In addition, the Banks incurred irreparable harm because they cannot be made whole by monetary damages that cannot replace the banking business they had developed over many years. In addition, the FDIC proceeded to sell the Banks' real estate, loans and other assets without providing the Banks with a due process hearing.

To the best knowledge of JML, no other court has ruled that judicial proceedings, that are held after the deprivation of property becomes final, satisfy due process. The Court of Appeals confuses and erroneously equates the initial taking of possession of property by the government with the government's disposal of the property after the initial taking. It also

overlooks the fact that the basis for this Court approval of the immediate takings in the cases erroneously cited by the Comptroller in support of his position, as well as being cited by JML, was that the owner's due process rights were protected by post-taking hearing opportunities to present their evidence and arguments to the regulatory agency, or in a judicial proceeding, prior to the time the property was disposed of by the government in a manner that finalized the deprivation of property. If the decision of the Court of Appeals is allowed to stand, it will be the first case, to JML's knowledge, in which banks have not been afforded the same due process rights as other parties, and will be in direct conflict with the consistent position of this Court "that some form of hearing is required before an individual [or corporation] is finally deprived of a property interest." 424 U.S. at 333.

The due process rights of banks should be no less than the due process rights of any other party. Although circumstances may exist when it would be in the best interest of the FDIC insurance fund and the public for the Comptroller to declare a bank insolvent and to appoint a receiver to immediately take over a bank, banks should be given the opportunity to protect themselves from overzealous, misguided or inexperienced bank examiners by having the opportunity to present their evidence and arguments showing why the appointment of the receiver should be revoked before the receiver is permitted to dispose of their assets. This view is corroborated by the fact that Congress has protected the due process rights of savings and loans by providing them with the opportunity for a prompt judicial "hearing on the merits" when they are declared insolvent and a receiver is appointed, 12 U.S.C. § 1464(d)(2)(B). Prior to FIRREA, the Federal Home Loan Bank Board, since 1933, has provided an administrative hearing in its *Rules and Regulations for the Federal Savings and Loan System*, § 206.2, Hearing on Appointment. As a result of the

Comptroller failing to provide banks with a similar administrative hearing procedure and Congress failing to provide banks with the same opportunity for a prompt judicial hearing as it has provided for savings and loans, the Comptroller and OCC, in their zeal to achieve their own agenda during the last several years, have ignored, and thereby have deprived, many banks of their due process rights when the Comptroller declared them insolvent, appointed the FDIC as receiver and permitted the FDIC to promptly dispose of their assets without providing the banks with the opportunity for a hearing.

This case further warrants the attention of this Court because the Court of Appeals relies heavily on *United States v. James Daniel Good Real Property,* 114 S. Ct. 492, 501 (1993), and, in doing so, misapplied the three factors this Court instructed should be considered in determining whether the circumstances warrant the postponement of a due process notice and the opportunity to be heard until after the taking of possession of the property. *Id.* at 501. Because the Court of Appeals failed to distinguish between the initial taking of possession of the property by the government and the disposal of the property by the government after it has taken possession, it erroneously considered the three factors set forth in *James Daniel Good,* in an attempt to support its ruling that due process does not require a hearing prior to disposal of the Banks' assets. The three-factor test is not applicable to determining whether a due process hearing may be held after the deprivation of property becomes final by disposal of the property by the government. Disposal of property by the government, that finalizes the deprivation of property before a hearing, violates the clear language of the Fifth Amendment the moment such disposal occurs — "nor be deprived of . . . property, without due process of law."

Although the Court of Appeals' discussion of the "government interest" factor is not relevant, since the three-factor

test is not applicable to the facts of this case, it is important for this Court to realize that the government did not have a strong interest in "swiftly disposing of the assets and liabilities" of the Banks, as the Court of Appeals asserts, App. 22a, because (i) the "insolvency" of the Banks was an "accounting" insolvency that was not caused by actual loan losses, but rather by the estimated reserves required by the examiners for possible future estimated loan losses, that had not occurred and that may never have occurred, which gave the Comptroller ample time to provide the Banks with notice and the opportunity to be heard, and (ii) because the operation of the Banks by the FDIC as a conservator, while the Banks were being given the opportunity to be heard, could not have caused any more damage or loss to the government or public than the transfer of all the deposit liabilities and liquid assets of the Banks to Signet, plus the large cash payment to Signet by the FDIC, which imposed on the FDIC and the public a result equal to a run on the Banks by depositors withdrawing all of their deposit accounts.[7]

B. Review Of Administrative Record That Does Not Contain Evidence And Arguments Of Bank Does Not Provide Due Process.

The Court of Appeals erred in ruling that "the judicial proceedings here and in the District Court satisfied the hearing requirements of the Fifth Amendment." App. 25a. The administrative record, on which the Court of Appeals based its finding that the Comptroller's decision and action was not arbitrary and capricious, did not contain any evidence and arguments of the Banks showing why the additional loan loss reserves were unreasonable and excessive. The administrative

[7]Discussion of the Signet Purchase and Assumption Agreements at pp. 2 and 3 of this petition.

record did not contain the Banks' evidence and arguments because the Banks were not given a meaningful opportunity to participate in the making of the administrative record by submitting their evidence and arguments for consideration by the Comptroller or the examiners and for inclusion in the administrative record.

In a similar savings and loan association ("S&L") case, involving an S&L that was declared insolvent and closed by the Federal Home Loan Bank Board ("FHLBB"), the issue of due process was raised when the Fifth Circuit was considering whether the language of the statute, 12 U.S.C. § 1464(d)(6)(A), that provides for a "hearing on the merits" for S&Ls, meant a *de novo* trial or judicial review limited to the evidence in the administrative record. *Woods v. Federal Home Loan Bank Board*, 826 F.2d 1400, 1412 (5th Cir. 1987), *cert. denied*, 485 U.S. 959 (1988). Before the Fifth Circuit decided to limit its judicial review to the administrative record, pursuant to the standard of review required by the Administrative Procedure Act, the Fifth Circuit Court acknowledged the due process issue and reviewed the administrative record to determine whether the S&L had had the opportunity to submit its evidence and arguments for consideration by the FHLBB and whether they were part of the administrative record. The Circuit Court found that the S&L had received notices that its actions were under scrutiny and that the S&L's best explanations and justifications were required. The Circuit Court further found that the S&L had the opportunity to present, and did present, substantial evidence and arguments to the examiners and supervisors that were included in the administrative record. After the receiver was appointed, the FHLBB gave the S&L notice of the substance of the pertinent evidence supporting each determination by the examiners, as well as the entire administrative record that contained all materials on which the FHLBB relied and the substantial amounts of

evidence and arguments submitted by the S&L. In the district court, the S&L was able to submit a multi-volume exhibit consisting of the evidence it had submitted to the examiners and their supervisors that were part of the FHLBB administrative record. *Id.* at 1413.

In stark contrast to the treatment of the S&L in *Woods*, the Banks were never given the opportunity to present their evidence and arguments to the Comptroller, any supervisory personnel or the examiners for their consideration and inclusion in the administrative record. For this reason, the Banks were unable to present to the District Court any evidence or arguments from the administrative record. The Banks were further stifled in presenting evidence because all of the Banks' documents and files are in the exclusive possession and control of the government and because the Comptroller elected not to include any of the Banks' loan underwriting and credit documents in the administrative record. In addition, the District Court would not expand the administrative record to include such bank documents. For these reasons, the evidence and arguments of the Banks were not before the District Court or Court of Appeals for their consideration and, therefore, the judicial proceedings did not provide the Banks with a due process hearing.

The Court of Appeals erred when it ruled that JML failed "to demonstrate that the record was in any respect inadequate as a basis for district court review of the Government's decisions." App. 14a. In so ruling, it ignored the fact that the Banks had not been given a meaningful opportunity to be heard and to participate in the making of the administrative record as had the S&L in *Woods*, ignored the dicta in *Fuentes v. Shevin*, 407 U.S. 67, 87 (1972), that the due process right to be heard does not depend on an advance showing that one will surely prevail at the hearing, and ignored the fact that

under the Administrative Procedure Act, 5 U.S.C. § 706(2)(B), when agency action is "contrary to constitutional right," Congress has instructed the reviewing court to "hold unlawful and set aside agency actions, findings and conclusions . . . . ," without reaching the issue of whether the agency action was arbitrary and capricious. If this decision of the Court of Appeals is allowed to stand and establish a precedent, due process will become nonexistent for banks when the Comptroller, based only on examination reports, declares a bank insolvent and appoints the FDIC as receiver to liquidate the bank's assets.

C. Administrative Record Not Sufficient For Court To Perform The Judicial Review Function Prescribed In Overton Park.

This case merits the review of this Court because the District Court and the Court of Appeals, in making their *de novo* review of the facts, failed to follow the instructions given by this Court in *Citizens To Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971), that a court reviewing claims under the Administrative Procedure Act, 5 U.S.C. § 706(2)(A), has the responsibility to make a "searching and careful" inquiry into the facts to "determine whether the decision was based on consideration of the relevant factors and whether there has been any clear error of judgment." This Court further instructed that although the agency's decision-maker is entitled to a presumption of regularity, "that presumption is not to shield his actions from a thorough, probing, in-depth review." 401 U.S. at 415. In this case, it was impossible for the District Court and Court of Appeals to make such an inquiry to test the findings and reasons of the examiners, because the administrative record does not contain copies of the pertinent loan underwriting and credit documents of the Banks that the examiners allege provide the evidence for their findings

and reasons that support their assessment of $31.6 million in additional loan loss reserves that made the Banks insolvent.

This issue regarding the adequacy of the administrative record directly impacts the responsibility of the courts to provide individual and corporate citizens with protection against arbitrary takings of private property by government agencies. If courts are permitted or restricted to reviewing only summary reports and memoranda prepared by employees of the agency that takes the private property, and are not required or able to test the findings and conclusions set forth in the reports and memoranda against the alleged evidence, applying the appropriate APA standard of review, then judicial review under the Administrative Procedure Act, 5 U.S.C. § 706(2)(A), will be a meaningless exercise that will have little, if any, capacity to protect individual and corporate citizens against arbitrary government takings of property.

This Court has ruled that courts are to consider the "whole" administrative record that was before the agency decision-maker at the time the decision was made. *Overton Park*, 401 U.S. at 419, and *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 488 (1951). This rule requires the inclusions in the administrative record of this case of all of the Banks' pertinent loan underwriting and credit documents that were available to the examiners for their examination, because the examiners were the decision-makers who determined the amounts of loan loss reserves the OCC required the Banks to set aside that made them insolvent.

The Comptroller, in declaring the Banks insolvent and appointing the FDIC as receiver, was merely reacting to the fact that the Banks were insolvent because of the additional loan loss reserves required by the examiners. This fact is corroborated by the Comptroller's reliance exclusively upon the findings of fact and conclusions reported by the examiners,

without any review of the underlying evidence or the evidence and arguments of the Banks. The examiners presented the insolvency of the Banks to the Comptroller as a *fait accompli*. The Court of Appeals demonstrated its lack of understanding that the decision of the Comptroller was in fact an institutional decision, totally dependent upon the examiners' examination of the Banks' loan portfolios and their assessment of the additional loan loss reserves, when it stated "In our view, the role of the examiners is irrelevant." App. 14a.

Examples of the importance of the Court reviewing the evidence, i.e., the Banks' loan underwriting and credit documents, and the risk of there being errors of fact and judgment existing in the documents prepared by the examiners, is demonstrated by a comparison of the discussion by the Court of Appeals of three loans based entirely upon the examiners' writeups, App. 18a-19a, and the discussion of the loans in the affidavits submitted by JML and ignored by the Court of Appeals. App. 62a-65a, 73a-78a.

With regard to the Square 316 Associates loan, the Court thought the examiner offered sensible reasons for discounting the value the personal guaranty and land securing the loan. The Court of Appeals accepts at face value the statement of the examiner that the local government has recently favored down-zoning without there being any substantiating evidence in the record or any evidence showing that down-zoning included large multi-acre residential lots. The Court of Appeals was unaware that the third-party appraisal, that was prepared by a respected appraiser who had a Ph.D. in appraising, valued the property in its "as is" condition and that the appraised value was based upon, not only the usual five comparable land sales, but in fact was based upon 10 comparable land sales, that supported an $11.8 million "as is" value that made the first and second trusts combined loan-to-value ratio only 63%. App. 77a. The statement of the examiner, who was from

Texas, that "it is not economically feasible to operate a farm on land costing $16,000.00 per acre," shows the examiner's total lack of knowledge of land values in Northern Virginia, including Prince William County. App. 77a. In addition, the examiner failed to consider, and therefore the Court did not know, that the Bank, in an abundance of caution, obtained an assignment of partnership interests in two mature real estate projects that had stabilized payment histories and served as a second repayment source, that made the value of the security far in excess of the principal of the loan. App. 78a. The $1.75 million, 43%, loan loss reserve required by the examiner was a clear error of judgment based upon the amount of security. The Court was also misguided by the simplistic approach of the examiner with regard to the guarantor's contingent liabilities, noting that they exceeded his estimated net worth by a ratio of more than 2-to-1, without any analysis of what portion of the contingent liabilities represented substantial risk and then comparing such contingent liabilities with the guarantor's net worth of $86 million and $12 million in cash and marketable securities. App. 77a.

With regard to the Amann loan, the Court of Appeals concluded that the $477,000.00 reserve was justified because the Banks did not have a current appraisal (appraisal made in 1989 when loan made) and the borrower had given a $4.4 million purchase money loan to a joint venture that was in financial difficulty. The Court of Appeals did not know that the $6.1 million value used by the examiner for the entire 110-acre assemblage was only the purchase price for the residential portion of the land assemblage and that the examiner did not include the value of the 35 acres of commercial property that added another $9.1 million to the value of the land. This major error is the reason the examiner rejected the $17.6 million third-party appraisal and the Bank's conservative discounted value of $11.6 million, which are 3.8 times and 2.5 times the amount of the

$4.5 million remaining balance of the loan. The examiner never corrected this major mistake of fact. App. 64a, 74a. Secondly, neither the borrower nor the joint venture purchaser of the residential property had defaulted on the loan as the Court of Appeals believed. The Court of Appeals did not know that the one-year loan was renewed upon the borrower paying $1 million and in accordance with the renewal terms of the loan commitment letter, which provided for annual one-year loan renewals, provided a portion of the principal was paid and the value of the remaining security was sufficient to cover the balance of the loan, because the examiner ignored those material facts. App. 64a, 74a. Thirdly, the borrower did sell the residential property and did provide a $4.4 million purchase money first mortgage loan to the joint venture that purchased the residential property, but the examiner never took into account the fact that the borrower assigned to the Bank the purchase money deed of trust and note, which continued the first deed of trust position of the Bank on the residential property in the event of a default by the joint venture or borrower. App. 75a. In addition, if the joint venture purchaser defaulted, the borrower, or the Bank, would have received back improved land that was ready for development and that had a greater value than when it was sold as raw land. Fourthly, the McDonalds, Inc. contract for $6.00 per square foot established the market value of the commercial property at $9,147,000.00, that was far in excess of the $4,586,000 unpaid balance on the loan. App. 65a, 75a. Based on the excessive amount of security and the fact that interest had been prepaid to the Bank for the entire year 1991, the amount of the reserve was excessive and a clear error of judgment.

With regard to the Bradley Arlington loan, the examiner required $2.3 million in reserves, that was a 40% reserve for a $5.7 million loan. The Court, in accepting the examiner's analysis at face value, that the second trust could not be paid

in full by refinancing the property, did not know that the examiner failed to acknowledge and consider the fact that the Bank had obtained an assignment of a 75% controlling interest in the partnership that owned the building securing the loan and that any residual debt of the second trust, that was unpaid from the refinancing of the building, was to be paid from the sale of the partnership interest, if necessary. The Court of Appeals did not know that the partnership interest was valued at $3.5 million, based upon the property's permanent loan capacity value of $26.5 million. App. 63a, 74a. The Court of Appeals did not know that the examiner misstated in his report that the cash flow of the project was not sufficient to pay debt service in spite of being shown to the contrary. The examiner ignored that the property was 98% leased, that the loan was current and that there had been no monetary default since the loan was granted in July of 1988. App. 63a, 73a. The worst mistake made by the examiner, which the Court of Appeals did not know, was that the examiner valued the property securing the loan based on the partnership tax accounting value, the cost of the property less depreciation, which has no bearing or relationship to market value. App. 64a, 74a.

The Court of Appeals, by accepting the examiners' reasoned explanations at face value, without testing them against the Banks' loan underwriting documents, and by ignoring the affidavits of loan officers submitted by JML, was unaware of the relevant factors that were not considered by the examiners and the material mistakes of fact that occurred that caused the examiners to make clear errors of judgment in the assessment of reserves for the loans.[8]

---

[8]The factors rejected or not considered by the examiners for the three loans support the loan officers' observations that it appeared as if the examiners were instructed to write down the Banks' loans (App. 69a, 83a) for any reason they could find to justify the "5" rating that was based on an examination of only 26 loans that violated the OCC reserve assessment policy not to value real estate securing loans at liquidation values.

CONCLUSION

JML respectfully requests the Court to issue a writ of certiorari to review the decision of the Court of Appeals in this case on the grounds that (i) the rulings of the Court of Appeals in this case conflict with prior rulings of this Court; (ii) the examination procedure used by the Comptroller to declare banks insolvent, appoint the FDIC as receiver and to promptly liquidate the assets of the bank, is a procedure that all national banks are subject to and is a procedure that has denied, and if allowed to continue, will continue to deny banks the due process protection that the Court has provided for other parties; and (iii) it is important to banks and all other entities that are subject to having their property taken by informal agency adjudications, for this Court to exercise its supervisory power to instruct the lower courts what the content of an administrative record should include in order for judicial review, pursuant to the Administrative Procedure Act, to provide the property owner with due process and to be sufficient for the court to perform its judicial review function.

Dated: October 1, 1996 Respectfully submitted,

William Joseph H. Smith
(Counsel of Record)
Stohlman, Beuchert, Egan & Smith, Chartered
1775 Pennsylvania Avenue, N.W.
Suite 400
Washington, D.C. 20006
(202) 452-1775

Attorney for Petitioner